

QAD monitoring report 2024 (Lecture A885 – 17.29 minutes)

In the year to 31 March 2024, ICAEW Quality Assurance Department (QAD) carried out 476 (2023: 496) audit monitoring visits to ICAEW regulated firms.

71% of 761 audits reviewed were either 'good' or 'generally acceptable' and this is the same figure as the previous year. The report does confirm that the following points need to be considered when putting this figure into context:

- The audit files selected by QAD are those considered to be the audit firm's most complex and/or risky, hence the overall result is not representative of the average audit quality across all firms' audits (which is likely to be higher).
- Only 8% of audit files were rated as 'requiring significant improvements' with the balance requiring improvements (which can be limited to missing documentation).

In addition, 88% of audits reviewed at the largest (i.e. Tier 1) firms were either good or generally acceptable. Only one of the 50 audit files reviewed at the largest firms required significant improvements.

Furthermore, ICAEW have identified several factors which appear to be contributing to the drop in the overall headline result from pre-pandemic levels, such as:

- New ways of working remotely.
- A significant shortage of staff (mirroring pressures in the wider UK economy).
- Audit client staff working remotely who are sometimes reluctant to engage with the auditor in person.
- Increased workload arising from new/revised auditing standards.

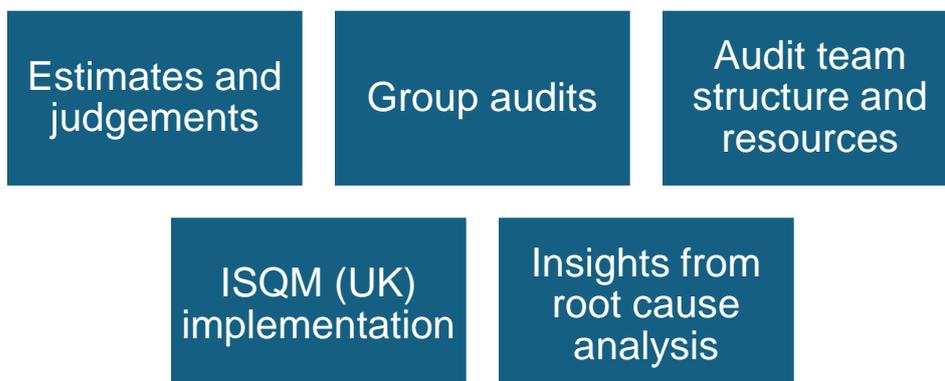
QAD continues to focus on those areas of the audit which they know are challenging to firms. Consequently, it continues to find weaknesses in certain areas such as those requiring estimates and judgements as well as group audits.

Audit monitoring reports published by the various professional bodies often appear to concentrate on what is going wrong with firms' audit work. However, this year's QAD report confirms that it is important to highlight that it sees a lot of good practice during audit monitoring exercises.

Many firms produce high-quality audit work carried out by experienced audit team members and the documentation 'tells the story' of how the audit was conducted and the resulting audit engagement partner's opinion on the financial statements. In addition, QAD have mentioned it also sees demonstrable scepticism being applied in these audits.

Challenges in audit work

The following challenges have been identified by QAD:



Estimates and judgements

Estimates include:

- valuations of assets, such as property or intangible assets;
- determination of a provision, such as against stock or a legal claim; and
- cash flow forecasts which underpin the directors' going concern conclusions.

Auditors must document how they have approached the audit of that estimate and the work they have done on the appropriateness and integrity of any underlying models. This includes documenting the work carried out on understanding key assumptions and sensitivity to changes in those assumptions.

Examples of weak audit work includes valuation or other reports copied and placed on the audit file without any work carried out on the report. This, of course, demonstrates a lack of professional scepticism.

Group audits

Group audits were featured in the 2022/23 QAD report. The key principle in group audits is that the UK group auditor must be able to supervise and direct audit work, even where the component auditor is located overseas.

It should also be borne in mind that ISA (UK) 600 *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)* has been revised for December 2024 year ends (and short periods) and the responsibilities of the group auditor have been set out even clearer.

Under ISA (UK) 600 (Revised), the group auditor will need to adopt an approach that starts at the consolidated financial statement level and conduct a risk assessment **across** the group rather than a 'bottom up' approach as has been seen in the past.

There are significant differences between the outgoing version of ISA (UK) 600 and ISA (UK) 600 (Revised) which must be clearly understood by audit firms. Some of these differences have been covered in previous quarterly updates.

Challenges may be faced by smaller audit firms where groups have subsidiaries that are located overseas. The principal risk for all firms is that they view the role of group auditor as that of an 'administrative' nature because they take inappropriate assurance from the involvement of component auditors without the necessary timely engagement and review of their work.

Audit team structure and resources

Deficiencies in audit work can (and often do) arise because of an ineffective audit team structure and a lack of resources. This has been particularly the case over the last couple of years due to a shortage of audit staff in the market.

The principal risk of an under-resourced audit team is that audit work is not carried out; or not carried out in accordance with the ISAs (UK). A lack of supervision and review processes throughout the duration of the audit can also contribute to deficient audit work.

Where deficiencies are pervasive (i.e. they affect multiple areas of the audit), there is a risk that the firm is reported to the Audit Registration Committee for further action.

ISQM (UK) implementation

QAD had previously stated in 2022/23 that part of its focus would be on ISQM (UK) implementation.

Where QAD had concerns about ISQM (UK) implementation, it asked for follow-up information to check progress following the visit.

In addition, it is important to emphasise that the firm's ISQM (UK) procedures must be evaluated on an annual basis to assess its effectiveness.

Root cause analysis

Approximately 90% of firms visited had implemented the ISQMs (UK). One of the key features of the ISQMs (UK) is root cause analysis. This is a relatively new concept for many firms so best practice will evolve in the fullness of time. However, QAD's initial observations are as follows:

- Development of ability within the firm to conduct effective root cause analysis, facilitating open and constructive discussion on 'what went wrong' is likely to have wider benefits in strengthening a positive culture of accountability rather than blame.
- Training organisations will provide valuable support and independence and objectivity to the process, but the effectiveness of their work will be very reliant on those in the firm arranging interviews and meetings with relevant individuals and so this is more complex

to outsource than routine reviews of completed engagements or provision of training courses.

- Whoever performs the root cause analysis, it must be a timely process to enable development of action plans and implementation of any changes within a reasonable timeframe.

Focus on 2024/25

QAD have confirmed that their focus for 2024/25 will be in the following areas:



ISQM (UK) 1

By 2024/25 firms should have their ISQM (UK) procedures in place. Remember, it is a requirement of ISQM (UK) 1, paras 53 and 54 to evaluate the firms' system of quality management and this evaluation must be documented indicating whether the system provides:

- (a) reasonable assurance;
- (b) reasonable assurance except for deficiencies that have a severe but not pervasive effect; or
- (c) does not provide reasonable assurance.

Ethical Standard 2024

The Ethical Standard issued by the FRC was changed in January 2024. QAD will focus on whether firms have carefully considered the requirement to assess fee dependency from a collection of entities with the same beneficial owner or controlling party, rather than simply for a company and its subsidiaries (which was previously the case).

Continuing changes in the audit market

The movement of larger and more complex audit clients from larger firms to smaller ones (including expanding consolidation) is likely to continue.

Audit firms wishing to take advantage of these opportunities must ensure they have robust audit acceptance criteria in place to ensure sufficient resources are available with the necessary competence to undertake this work to an acceptable standard.

ACCA quarterly audit monitoring report

ACCA issue a quarterly audit monitoring report and the September 2024 report focuses on ISQM (UK) 1 implementation.

ACCA notes that their monitoring team find that firms often either:

- do not have a system of cold file reviews in place; or
- have not communicated the results of any such reviews sufficiently to the wider audit team.

ACCA's report clarifies that ISQM (UK) 1 makes it clear that monitoring and remediation is more than just completing cold file reviews and firms need to be aware that all areas of the system of quality management must be considered.

ACCA has also confirmed that an audit monitoring review of the firm **cannot** be used as a cyclical review. However, the results can be used to inform the timing of the next review.

In terms of the **annual evaluation**, this must be completed at a point in time. The person with ultimate responsibility must carry out this assessment and reach a conclusion to confirm the system is:



ACCA have identified firms:

- have asserted that they have conducted an annual evaluation, but have not documented the process;
- have not reached a conclusion having completed the review; or
- have not completed an annual evaluation.

ACCA have also commented that during its monitoring review, a consistent finding has been that firms do not have an appraisal system for those persons with responsibility for the system of quality management. Firms should implement a periodic appraisal which considers the results of any monitoring activities as well as the conclusion of any monitoring activities and the conclusion of the annual evaluation.